IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 492

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,

Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

PETITIONER'S REPLY BRIEF

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITIONER'S REPLY BRIEF

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The respondent has failed to overcome the facts and authorities which show that this petitioner is entitled to the deduction sought.

The respondent cites (Br. 7, 8) cases in support of the rule that an exemption provision in a tax act should be strictly construed. But the simple issue before this Court does not turn upon a strict or liberal construction of the statute. The Act (Br. for the Pet., p. 2) provides that the petitioner shall have a deduction in the amount of:

"all interest paid • • • within the taxable year on its indebtedness." The respondent points out (Br. 9) that this Court has held that the *"interest"* for which this deduction is provided means: "the amount which one has contracted to pay for the use of borrowed money." The petitioner does not seek a more liberal construction.

It is beyond question that the obligations, upon which the payments here involved were made, constitute *"indebtedness."* The parties have stipulated (R. 110, 118A) that these obligations *for the payment of money* were *"absolute obligations* • • • not in any sense contingent upon the happening of future events." Accordingly, the Circuit Court of Appeals below has held (R. 132) that the petitioner's liability *on all the funds involved* constitutes "indebtedness" within the meaning of the Act. The respondent does not question that decision. It is the *law of the case.*

The simple issue before this Court, therefore, is whether the so-called "excess interest dividends" paid by the petitioner constitute: "the amount which one [the petitioner] has contracted to pay for the use of borrowed money."

In contending that these payments did not constitute consideration paid for the use of borrowed money, the respondent bases his contention on *but two facts.* These *two facts* which, as hereinafter shown, do not support his contention, are:

1. The payments were called "excess interest dividends" (R. 118A); and
2. The determination of the specific rate at which "excess interest dividends" would be paid in 1933 was within the discretion of the petitioner's Board of Directors *until* that determination was made at *the beginning of that year* (R. 112).

The first of these facts has no probative value since the term "excess interest dividends" is wholly non-committal on this issue. The respondent (Br. 8) italicizes the word: "*dividends.*" The petitioner prefers to italicize the word: "*interest.*" There is no magic in the use of either term. *Mertens on the Law of Federal Income Taxation* (Callaghan & Co., 1942) vol. 4, Sec. 26.10, and the authorities there cited. There is greater significance in the fact that the same printed provisions of the contracts, which call these payments "excess interest dividends," expressly state that these payments constitute: "*interest* in excess of 3% per annum." (R. 74, 118A, italics supplied.)

That the payments did in fact constitute *interest* and not *dividends* is shown by the *facts* pointed out under Point I of the Brief for the Petitioner, and by the authorities there cited; *facts* and *authorities* which the respondent in his brief has not attempted to dispute.

The fact that the determination of the specific rate at which "excess interest dividends" would be paid in 1933, was wholly within the discretion of the petitioner's Board of Directors *until* that determination was made at *the beginning of that year*, is utterly lacking in significance. The amount of interest which any prospective corporate borrower *offers* to pay for the use of borrowed money is always (Br. 8) "determinable at the will of the company's directors" *prior to the making of the offer.* But when the rate of interest to be offered has been determined and is offered, and there is an acceptance of that offer, and the parties to the loan transaction thereby mutually agree upon that rate, payments made in accordance therewith constitute (Br. 9): "the amount which one has contracted to pay for the use of borrowed money."

The significant and controlling facts are those which occurred *subsequently*, as stipulated by the parties and

found by the Tax Court, which are discussed under Points I, II, III and IV of the Brief for the Petitioner. As there pointed out these subsequent facts show that, at the beginning of the taxable year, the petitioner's Board of Directors did exercise its discretion and did offer to pay *interest* at a specific excess rate for its retention and use of funds held during that year under the supplementary contracts here involved; that this offer was accepted, and resulted in legally binding contractual obligations to pay the so-called "excess interest dividends" as *interest* for the retention and use of such funds.

Only by closing his eyes to these subsequent facts can the respondent justify his repeated assertion (Br. 6, 8, 9, 11, 12 and 13) that the payment of these so-called excess interest dividends was "a payment which may be made or withheld at the will of the directors."

With reference to this repeated assertion, it would be enlightening to learn how the respondent distinguishes the interest payments made under *new* supplementary contracts issued in 1933,[1] at the *guaranteed minimum rate* of 3% from those made under these *new* contracts at *the specific excess rate* which had been determined and declared *at the beginning* of that year (R. 112).

Just as the specific *excess rate* of interest offered for 1933 was (Br. 8) "determinable at the will of the company's

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[1] A large proportion of the total funds upon which these so-called "excess interest dividends" were paid, were held under *new* supplementary contracts entered into *after* the specific excess rate for 1933 had been determined and declared at *the beginning of that year*. See: Point II of the Brief for the Petitioner, where it is pointed out that the findings of fact show that *at least* $7,520,481.00, or 20% of the total funds involved were held under such *new contracts*.

As a matter of fact, the petitioner held $15,044,700.00, or 40% of the total funds involved herein under these *new* supplementary contracts so issued in 1933. See: *Insurance Year Book, 1934, Life Insurance* (The Spectator Co.) p. 330; and item 10, page 2, of the petitioner's *Annual Statement for 1933*, filed with the Insurance Department of the State of New York.

This Court has held that it can take judicial notice of the facts shown in this petitioner's annual statement: *Equitable Life Assurance Society* v. *Brown* (1909), 213 U. S. 25 at page 42, cited by the respondent (Br. 8).

directors" *prior to the making of that offer*, so it has always been within the power of the petitioner's Board of Directors to determine what, if any, *guaranteed minimum rate* of interest would be offered in its policy provisions for supplementary contracts. The consideration *offered* by the petitioner *at the beginning* of 1933 for its retention and use of funds under new supplementary contracts which *thereafter* might be entered into, was a gross rate of interest consisting of the *guaranteed minimum rate of 3%* plus the *excess rate then specified*. Each of these component rates had been determined (Br. 6, 8) "at the will of" and (Br. 8, 9, 12, 13) "within the discretion of" the petitioner's Board of Directors.

How can the respondent distinguish between: (1) the payment made at this *guaranteed minimum rate of 3%* for which the petitioner is admittedly entitled to a deduction; and (2) the payment made at the *specified excess rate* for which the respondent insists that the petitioner is *not* entitled to a deduction? In the case of each new supplementary contract, both of these component payments were made on the *identical fund* under the *identical contract* entered into pursuant to the *identical offer* (R. 118A). Both of these component payments were made pursuant to the terms of the *identical offer* and quite obviously for the *identical purpose*, i. e., as consideration for the petitioner's retention and use of the fund held. Both payments had been unconditionally promised as *interest*, at the respective rates *specified*, and were to be paid regardless of what surplus the petitioner then had or what profit or loss it might thereafter experience (R. 110, 118A). How can they be distinguished?

The respondent expressly refuses (Br. 8) to concede that the so-called excess interest dividends need not be paid from surplus. No *facts* are cited to justify this refusal nor does the respondent attempt to refute the *facts*

and *authorities* cited by the petitioner (Br. for the Pet., Pt. 1) which show that its promise to pay this *interest* at the excess rate *specified* was an unconditional promise made without regard to the surplus or profits which it then had or might thereafter enjoy.

The respondent does admit that (Br. 12, fn. 6)

> *"the provision of the New York Insurance Law • • • authorizing the payment of excess interest does not in terms require that such excess be paid from surplus • • •."*

In making this admission, however, the respondent expresses a (Br. 12) "doubt that the directors of the company would or properly could declare excess interest dividends out of capital." In support of this "doubt," and by way of intimating that this excess interest must have been a distribution of surplus, he points out (Br. 12, fn. 6) that:

> "The provision of the New York Insurance Law, • • • authorizing the payment of excess interest • • • is found in a section of the law entitled 'Distribution of Surplus to Policyholders.'"

But this statutory provision which authorizes the petitioner's undertaking to pay the *"excess interest"* here involved, appears in the third paragraph of this Section 83, which *expressly* deals with this and other subjects, *as matters not concerned with a distribution of surplus.* The entire section is set out in an appendix hereto.

In citing cases and texts which deal with the distribution of *surplus* to *policyholders* (Br. 8, 12), the respondent is apparently confused as to the *facts* in this proceeding. The issue before this Court has nothing to do with distribution of *surplus to policyholders.* The following cases and portions of texts cited by the respondent (Br. 8, 8fn. 2,

12fn. 6) deal solely with distributions to *policyholders* of amounts which are admittedly *surplus:*

Greeff v. *Equitable Life Assurance Society* (1899), 160 N. Y. 19, 32;
Equitable Life Assurance Society v. *Brown* (1909), 213 U. S. 25, 47;
Berryman v. *Bankers' Life Insurance Co.* (1907), 117 App. Div. 730;
Penn Mutual Life Insurance Co. v. *Lederer* (1920), 252 U. S. 523;
W. F. Gephart, *Principles of Insurance: Life* (1917) pages 257-258;
S. S. Huebner, *Life Insurance* (1921) page 252.

Nothing held or said in any of these cases or in the portions of the texts cited has anything to do with money owed by a life insurance company to the *beneficiaries* of its matured policies, or to any other *creditor*, or with payments made to *beneficiaries* or other *creditors* whether such payments be termed "interest" or "dividends."

With reference to the above citations, see Point I of the Brief for the Petitioner where the *facts* and *authorities* are fully discussed; where the essential difference between *dividends paid to policyholders* and the so-called *"excess interest dividends"* here involved is pointed out; and where it is shown that these so-called "excess interest dividends" were payments made to *beneficiaries* as *interest* on the debts owed to them by this petitioner.

The respondent cites (Br. 9) cases in which corporate taxpayers have been denied deductions for *dividends* paid on the *stock* of the respective corporations, which the taxpayers had attempted to deduct as "interest paid on indebtedness." But those cases were decided upon the absence of a debtor-creditor relationship between the respective corporations and their stockholders and, there-

fore, cannot support the respondent's contentions here where the debtor-creditor relationship between the petitioner and the beneficiaries *as to all the funds involved* is beyond question. Furthermore, the reasoning of the opinions in these cases which the respondent cites shows that this petitioner is entitled to the deduction here at issue. See especially: *John Wanamaker Philadelphia* v. *Commissioner* (C. C. A.—3), decided December 30, 1943 (1944 C. C. H. par. 9124; 1944 P-H, par. 62323). This is so because the "excess interest dividends" here involved have *all* the characteristics which the opinions in these cases hold to be of importance in indicating that payments constitute deductible interest:

(1) The payments here involved were made upon obligations for the payment of money which had *fixed or determinable maturity dates* (R. 118A);

(2) These payments *accrued and were payable even in the absence of profit* (R. 110, 118A);

(3) They accrued at a *specified* excess rate which was *fixed* for the year (R. 112, 118A);

(4) They accrued and were payable to *beneficiaries* who had no voice in the management of the company and who, in the event of the petitioner's insolvency, were entitled to share in its assets *before* the policyholders.

Mayer v. *Attorney General*, 32 N. J. Eq. 815, at page 821.

(5) The payments were made as consideration for the retention of funds which had not been invested *at the risk* of the petitioner's business.

Mayer v. *Attorney General*, 32 N. J. Eq. 815, at page 821.

The respondent cites (Br. 10, fn. 5) *Missouri State Life Insurance Co.* v. *Commissioner* (C. C. A.—8, 1935) 78 F. (2d) 778, but that decision was concerned, not with *supplementary contracts,* but with *tontine dividend deposits* which accrued to those policyholders, *if any,* who survived the twenty year period. The court there held that this *"contingent policy liability"* was not *"indebtedness"* and therefore could not support a deduction for "interest paid on indebtedness." There is no question as to the *"indebtedness"* in the instant proceeding for *as to all the funds involved* it was held below (R. 132) that the petitioner is entitled to a deduction for interest paid on *indebtedness* in the amount paid at the guaranteed minimum rate, and the respondent does not question the correctness of that decision.

The respondent cites (Br. 10, fn. 5) *Penn Mutual Life Insurance Co.* v. *Commissioner* (C. C. A.—3, 1937), 92 F. (2d) 962, but that decision is to be distinguished by the facts stated by the court in its opinion in that case as pointed out on page 15 of the Brief for the Petitioner.

The respondent cites (Br. 10 fn. 3) cases in support of his regulations as "an appropriate guide in interpreting the statute." But as noted under Point VI of petitioner's main brief *those regulations require the allowance of the deduction here at issue.*

The respondent cites (Br. 9) *Old Colony R. Co.* v. *Commissioner* (1932) 284 U. S. 552 at pages 560 and 561, but in so far as this decision is at all in point it clearly supports the position of this petitioner. This Court there said:

> "The popular or received import of words furnishes the general rule for the interpretation of public laws."

* * * * * * * * *

> "And as respects 'interest' the usual import of the term is the amount which one has contracted to pay for the use of borrowed money. *He who pays and he who receives payment of the stipulated amount conceives that the whole is interest.*" (Italics supplied.)

The amount which this petitioner "contracted to pay for the use of borrowed money" included the so-called excess interest dividends at issue here (Points I, II, III, and IV of petitioner's main brief). These payments, at the *specific excess rates* which had been promised at the beginning of the year, plus those made at the *guaranteed minimum rate of 3%, together* constituted *"the stipulated amount"* of which "the *whole* is interest."

That this was the popular understanding is indicated by the published *gross rates* at which life insurance companies respectively will pay interest on the proceeds of policies left with them under supplementary contracts. For the current year these gross rates for most of the leading life insurance companies are tabulated and published in *Best Insurance News, Life Insurance*, vol. 44, no. 9, January, 1944. For similar tabulations of these gross rates for various companies for 1933, see: *The Spectator*, vol. CXXX, no. II, January 12, 1933, page 25; and no. XIX, May 11, 1933, page 36. In these tabulations the gross rates, i. e., guaranteed minimum plus the specific excess rate for the year, are published under the heading: "Rate of Interest Payable in 1933 on Proceeds of Policies." The gross rate for this petitioner is there shown as 4.65% for the year 1933. This of course includes the guaranteed minimum rate of 3% plus a specific excess rate of 1.65%.

Of this "stipulated amount • • • the *whole* is interest." *Old Colony R. Co.* v. *Commissioner, supra.*

CONCLUSION.

It is, therefore, respectfully submitted that the judgment of the court below, on the issue here involved, should be reversed.

Respectfully submitted,

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Dated, March 7, 1944.

APPENDIX

Section 83 of the New York Insurance Law

(As in effect throughout the year 1933)

NOTE: The paragraphs of this section were not numbered until 1934. However, since the third paragraph has been cited in the briefs of both parties as Sec. 83(3), the paragraphs are here numbered as they subsequently were in the following year.

§ 83. Distribution of surplus to policyholders. 1. Except as herein provided, every domestic life insurance corporation heretofore or hereafter organized, whether incorporated by special act or under a general statute, anything in its charter or certificate of incorporation or in such special act or general statute to the contrary notwithstanding, shall provide in every policy issued on or after the first day of January nineteen hundred and seven, that the proportion of the surplus accruing upon said policy shall be ascertained and distributed annually and not otherwise. Upon the thirty-first day of December of each year, or as soon thereafter as may be practicable, every such corporation shall well and truly ascertain the surplus earned by such corporation during said year. After setting aside from such surplus such sums as may be required for the payment of authorized dividends upon the capital stock, if any, and such sums as may properly be held for account of existing deferred dividend policies, and for a contingency reserve not in excess of the amount prescribed in this article, every such corporation shall apportion the remaining surplus equitably to all other policies entitled to share therein. Except in the case of a term or an industrial policy, the share of surplus so apportioned in the case of a policy issued on or after the first day of January, nineteen hundred and seven shall, at the option of the owner of the policy, be payable in cash, or shall be applicable to the payment of any premium or premiums upon said policy or to the purchase of a paid-up addition thereto or shall be permitted to accumulate to the credit of the policy at such rate

of interest as shall be allowed by the company, and with such interest shall be payable upon the maturity of the policy or shall be withdrawable in cash by the owner of the policy on any anniversary of the date of issue thereof. Such corporation may require the owner of the policy to elect the manner in which said dividends shall be applied as above provided by mailing a written notice of the amount of the said dividends and the options available as aforesaid in a sealed envelope in the manner required by the provisions of this chapter for notices of premium payments, and in case the owner shall fail to notify the company in writing of his election within three months after the date of the mailing of said notice, the surplus shall be applied by the company to the purchase of a paid-up addition to the sum insured.

2. In the case of a term policy issued on or after the first day of January, nineteen hundred and seven the share of surplus so apportioned shall be payable to the owner of the policy in cash or shall be applicable to the payment of any premium or premiums upon said policy, or if so provided in the policy shall be permitted to accumulate to the credit of the policy at such rate of interest as shall be allowed by the company and in such case shall be payable upon the maturity or expiration of the policy or shall be withdrawable in cash by the holder of the policy on any anniversary of the date of issue thereof. In case of industrial policies the share of surplus so apportioned shall be payable annually in such manner as may be determined by the company with approval of the superintendent of insurance. The dividends declared as aforesaid in the case of a policy issued on or after the first day of January, nineteen hundred and seven, shall be payable respectively either upon the anniversary of the policy next after said thirty-first day of December, or upon a day certain in the year following said date, according to the rules of the corporation or the terms of the policy, and upon the sole condition that the premium payments for the policy year current upon said thirty-first day of December shall have been completed, except that, as to all policies whose anniversaries shall occur after April thirtieth, nineteen hundred and twenty-one, the company may, in lieu of complying with the

foregoing provision relating to time of payment, make such dividends payable thereafter upon the anniversary of the policy next following each thirtieth day of April, and upon the condition that the premium payments for the policy year current upon such thirtieth day of April shall have been completed.

3. This section shall not apply to any stock life insurance corporation which on or after the first day of January, nineteen hundred and seven, shall transact and shall represent itself as transacting its business exclusively upon a nonmutual basis and shall after said date issue only nonparticipating policies. Both participating and nonparticipating policies may provide that in addition to the rate of interest guaranteed by the company to be paid on deferred payments of the proceeds, excess interest may be paid thereon at such rate as the company may annually declare, and the inclusion in any nonparticipating policy of such provision shall not be construed to make the policy participating. This section shall not apply to paid-up or temporary and pure endowment insurance issued or granted in exchange for lapsed or surrendered policies. A foreign life insurance corporation which shall not provide in every participating policy issued or delivered in this state on or after the first day of January, nineteen hundred and seven, that the proportion of the surplus accruing upon said policy shall be ascertained and distributed annually and not otherwise, and which shall not ascertain and distribute the surplus accruing upon said policies annually either by providing for their payment in cash or their application to the payment of premiums or to the purchase of paid-up additions or for their accumulation as above provided in the case of domestic corporations, shall not be permitted to do business within this state.

Amended by L. 1920, ch. 296; L. 1927, ch. 467.